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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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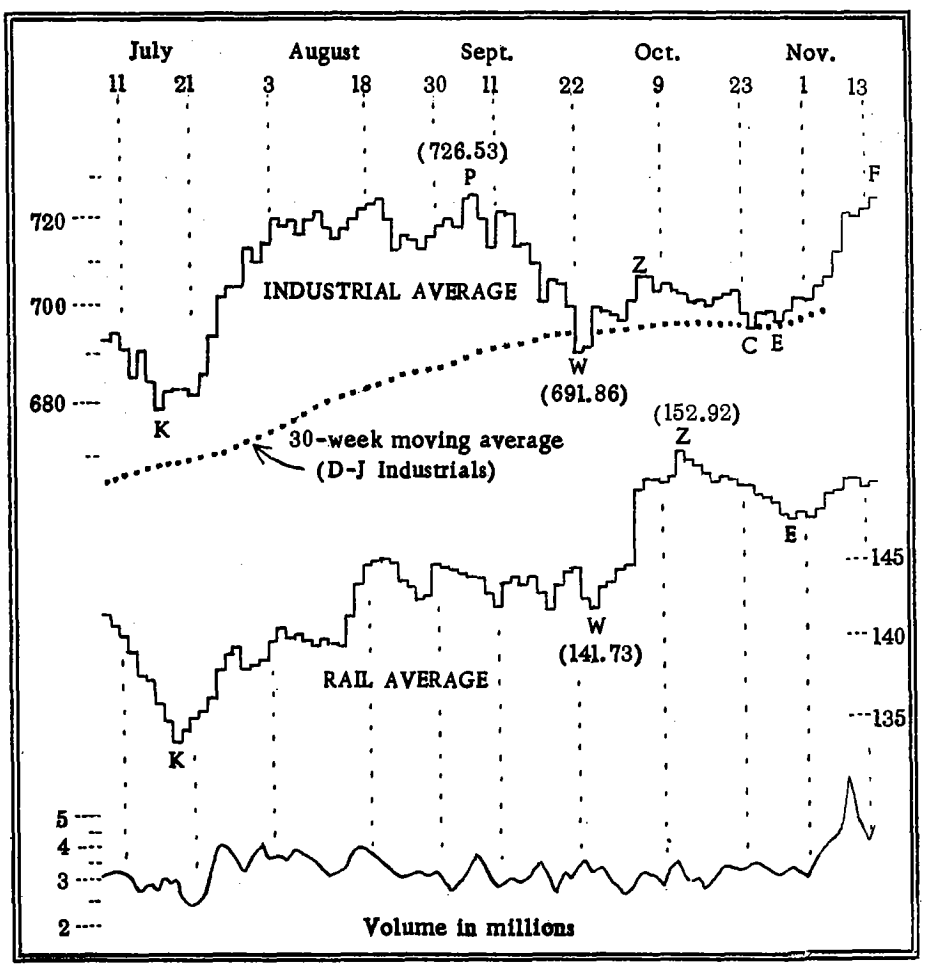
THE MARKET Over the last few months Wall Street's analysts gave forth with their share of bullish and bearish opinions while the market did little or nothing. During the past two weeks it was the market itself that did the "talking", and, as usual, the price movement provided the final authority. Within a period of thirteen consecutive trading days, the Industrial Average rose 31 points while Rails tended to follow "in gear". On Monday (November 13) the Industrial Average rose above its September bull market peak to the highest level in history (728.43). Rails lagged, and as of this writing, the carriers will need to advance better than two points (above 152.92) to confirm the Industrial high.

The rally since E has been of the explosive variety. The literally vertical Industrial rise was punctuated on November 8 by a nine point advance with accompanying volume of over 6 million shares. Considering the extent and speed of the E-F movement, it would now be perfectly normal for the market to undergo a corrective decline. Such a decline might serve to retrace 1/3 to 1/2 of the E-F gains. Thus, if Industrials retreat to the 713-717 area with Rails holding above their preceding low at E (147.63), and if volume contracts on the decline, the situation will remain bullish.

For the first time since March the two Averages are now in position for a possible joint penetration of the bull market highs. As a rule, the most important penetrations occur when both Averages better primary peaks within a short span of time. For this reason, when Rails (on October 10) rose above the March 22 high, I wrote that the penetration was "hopeful but not impressive" (the Rail penetration came seven weeks after the Industrial bull market high).

In the present situation, if Rails can shortly better Z (152.92), thereby confirming Monday's new Industrial high at F, the implications will be extremely bullish. In view of the violent rise since E, however, this writer would be more impressed by a consolidation from current levels, followed by a renewed advance which would take Rails above Z and Industrials to a new high.

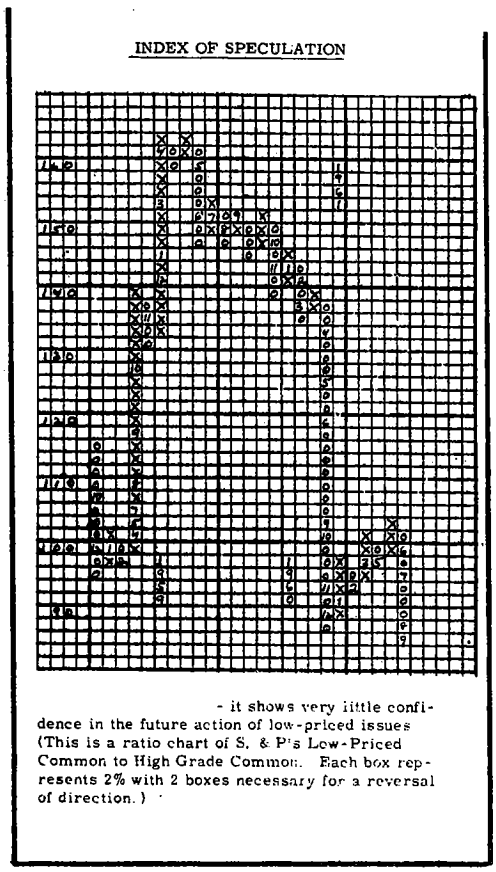


ABOVE "700" The concept of the moving average has been gaining popularity, yet few investors understand either its meaning or its use. For the first time in history, the long-term (30-week) moving average of the D-J Industrials has risen above the 700 mark (see chart, page 1). After leveling out (while the market consolidated) during September and October, the moving average climbed to a new peak during the week of November 1. Moreover, this event took place in an area which was fraught with anxiety, fear and unfavorable international news. Now, exactly what is the significance of this probe into new high territory by the 30-week moving average?

As I see it, it means that informed investors (in the face of widespread fear and uncertainty) have seen fit to pay the highest average price in history for the Industrial Average. If the informed elements in the market, the type of men who buy the "blue-chip" Dow stocks, are willing to pay a new average high for the Industrial Average, it stands to reason that they must sense bullish developments ahead. Whether there is to be a cessation of Russo-American hostilities, whether the American consumer is about to go on another spending spree, whether corporate earnings are headed sharply higher, cannot be known at this time. What we do know is that there is an excellent chance that the "crowd" will eventually follow the early lead of the "investment money". In the past, when the moving average of the Dow Industrials has leveled off, then risen into new high ground, the move has been followed by at least a few months of further upside action. Thus, the time would appear to be approaching for a spreading out of current investment-grade buying into other stock groups (with the probability that even the most marginal and speculative groups will finally be engulfed). That the stage may be setting for such a development will be discussed in the next paragraph.

LOW-PRICED STOCKS The last Letter (see also Letter 155) commented upon the reaction which had been underway on the American Exchange. The "junior" Exchange contains a great many stocks which are of lesser quality than those listed on "The Big Board". For this reason, the action on the American Exchange tends to reflect nationwide speculative sentiment (as opposed to informed investment opinion). Judging from the pattern of the advance-decline ratio on the American since the first quarter, it was concluded that speculative sentiment had been steadily decreasing. As further proof of this, it might be well to review the recent action of Barron's Low-Priced Stock Index . The movements of the low-priced "cats-and dogs" provide another classic indicator of speculative and "crowd" sentiment, and the long-term pattern of the L-P Stock Index has been commented upon in many previous Letters.

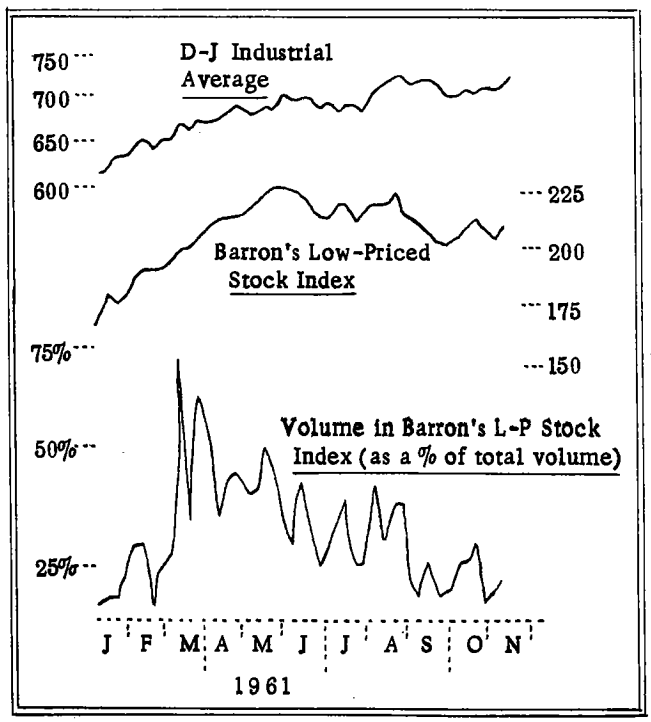
From the 225 peak of May, 1961, the L-P Index declined to a low of 201 at the end of September. Note that the accompanying chart shows the price action of the L-P Index and the volume of trading in the twenty stocks which comprise Barron's L-P Stock Index (volume is shown as a percentage of total N.Y. Stock Exchange volume). From a March high of 74% of total volume, L-P stock volume dropped steadily to a late September low of 18% of total Exchange volume.



- it shows very little confidence in the future action of low-priced issues (This is a ratio chart of S. & P's Low-Priced Common to High Grade Common. Each box represents 2% with 2 boxes necessary for a reversal of direction.)

The chart suggests (1) that speculative sentiment, as represented by the price movements of the low-priced stocks, has dropped to a low level; (2) that the drop in low-priced stocks was not a result of heavy liquidation in those issues--it resulted from lack of interest and a collapse in general speculative sentiment. Had important liquidation occurred in low-priced stocks, we would have expected waves of high or increasing volume (as a percentage of total N.Y. Stock Exchange volume) to batter the L-P Stock Index. Such was not the case.

An interesting sidelight on the low-priced stock situation is provided by my friends at Chartcraft, Inc. This point-and-figure chart shows the relationship of S. & P.'s low-priced stock index and the S. & P. High-Grade Common Index. The recent low to which Chartcraft's Index has dropped denotes a great lack of faith in any forthcoming rise in "cats-and-dogs". In studying the three distinct downward swings on this chart, one wonders if the stage is not being set for a reversal. Obviously, the more extreme the swing on any chart, the more the odds favor the inevitable change in direction.



CONCLUSION: Between October, 1960, and April, 1961, Barron's L-P Stock Index rose from 164 to 225. The subsequent drop from 225 to the recent low of 201 retained better than half of the previous October-April gains. The fact that the L-P Index did not break below the halfway point (Dow's 50% Principle) suggests that the L-P Index will again approach or better the April, 1961 peak. Volume indications on the decline did not suggest that important liquidation occurred in low-priced issues. For these reasons, it is a reasonable expectation that before this bull market is over, speculative interest will again grip the "cat-and dog" sector of the market. Against this background, I believe that diversified positions in such stocks

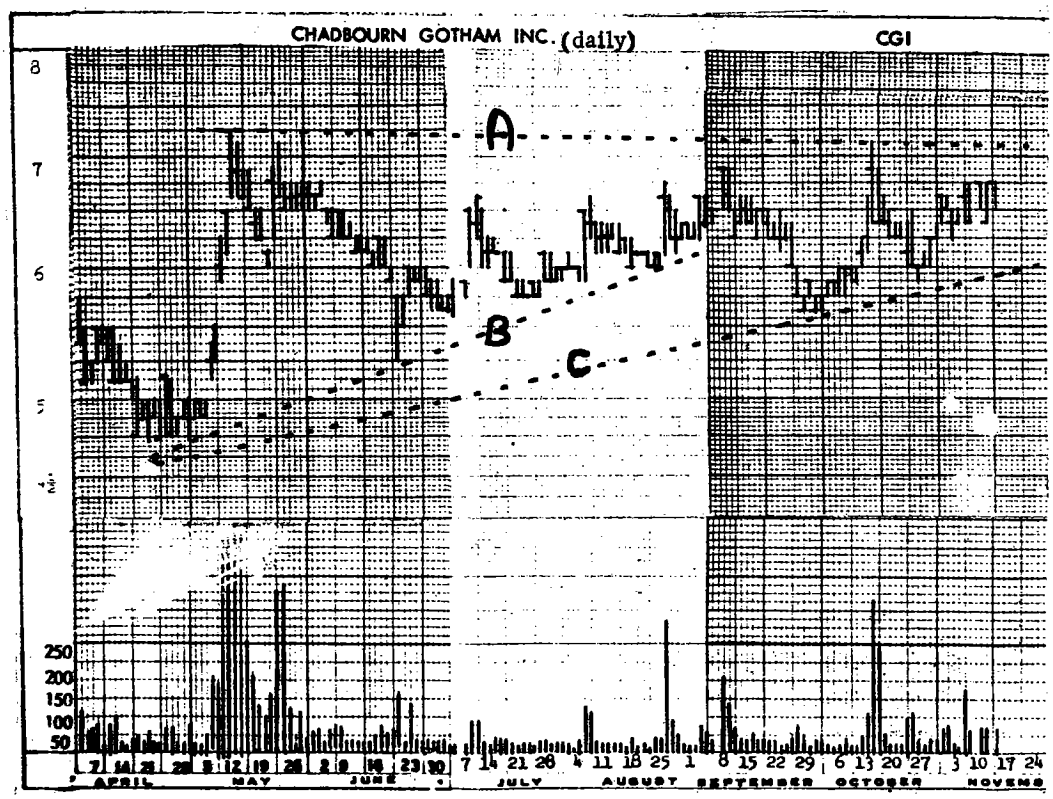
as Hupp, Sparton Corp., Libby McNeill, U. S. Industries, Burlington, Chadbourn Gotham, Coty, etc. might gradually be assumed.

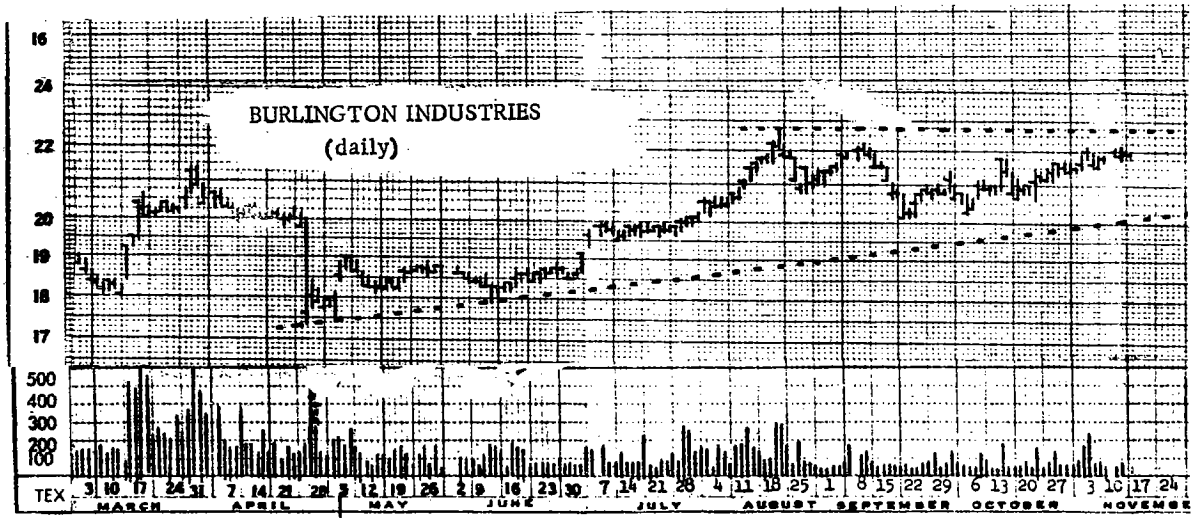
STOCKS On an expanded list of forty-five "key" stocks, twenty-four are now above their 10-week moving average. This is slightly better than 50%, but it suggest a market which is, and has been, viciously selective.

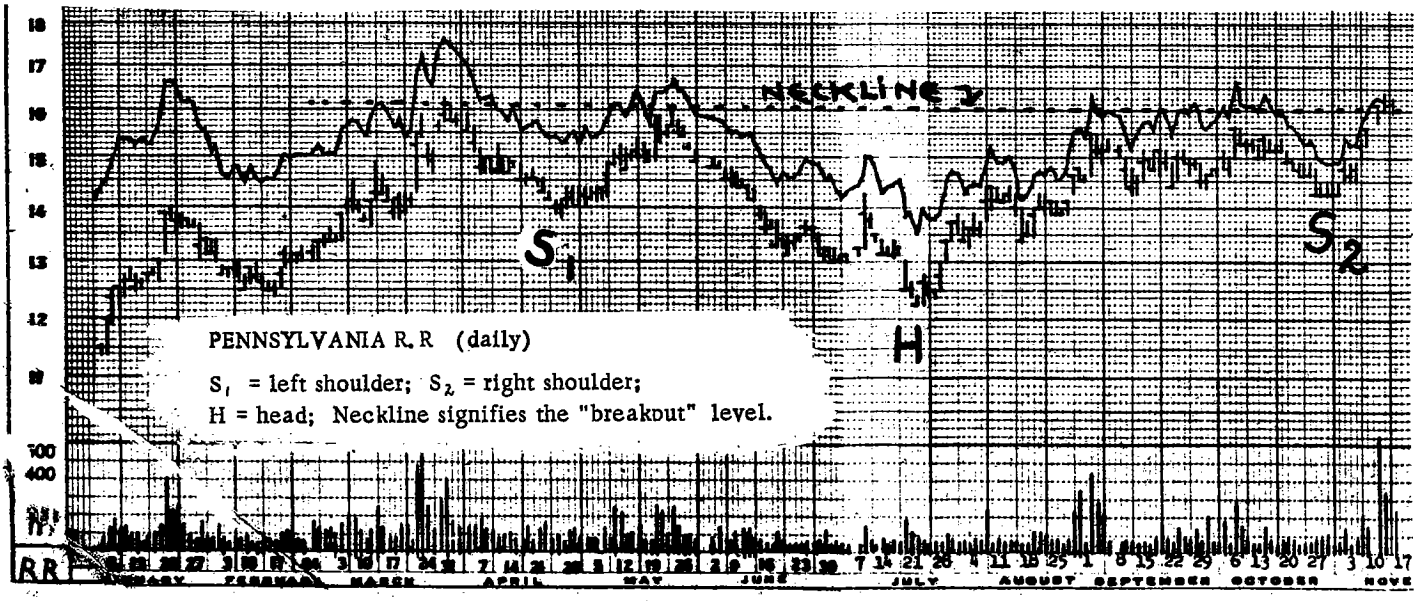
Chadbourn Gotham was recommended as a "buy" in Letter 155. Nothing has happened to CGI since then as far as making money for buyers is concerned. The objective was a bettering of the upper trendline (A) at 7 1/4. Following Letter 155 CGI broke below trendline B, then reconsolidated above the ascending trendline marked C. I still like CGI, and the stock can be bought again on the strength of the continuing bullish formation. A move above trendline A (7 1/4) would be a clean "breakout".

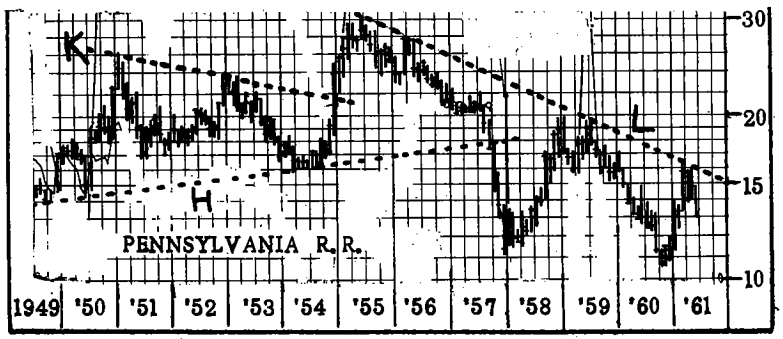
Interestingly enough, another softgoods stock, Burlington, is in a position to be bought. BUR has been in a rising trend since April, and despite market weakness, has gradually moved into position for a potential upside breakout. Buy the stock now for a move above 23. Should BUR hurdle the 23 level, the next objective would be the all-time high of 26 1/4.

Letter 157 included long-term monthly charts of three depressed Eastern Rails. One of those was Pennsylvania. The chart from Letter 157 is again reproduced (page 4) together with a daily chart of the recent movements. Note that at 16 PA has broken above a descending trendline which has been in effect since 1955 (see monthly chart). On the daily chart PA is seen to have formed a large inverse "head-and-shoulders" formation, and the stock is now flirting with the breakout point at about 16 1/4. A rise into the upper 16 to 17 area would be strongly bullish for the old "Pennsy", and I recommend purchases at the market.









The Office Equipment group is one of the strongest groups on the "Board". A laggard in the group has been Burroughs. BGH has been subject to a long descending trendline which has held in effect since the 1959 top. On Monday (November 13), BGH broke out of the great triangle which has been forming since late 1960, and in doing so it necessarily hurdled the three-year descending trendline. I list Burroughs as "a buy" at the market.

TECHNICAL NOTES: On the E-F rise the 5-day average of new highs rose to 92, the highest level since June 6. Concurrently, the advance-decline ratio climbed to its highest level since June. Both event are indicative of underlying market strength and hold bullish connotations.

Written Tuesday, November 14, at 10 A.M.

All stock charts courtesy of Traders Research, P.O. Box 6185, Lambert Airport, Mo.